Quebec June 2020 Fiscal Update – Using Fiscal Room to Respond to Covid-19

Finance Minister Éric Girard presented this Friday an Update providing details about the impact of Covid-19 on the province's economy and financial situation.

Deep recession but focus remains on potential

In Quebec, the government closed the economy faster and larger lockdowns were imposed than in other provinces. As such, Quebec currently experiences a deeper recession than the rest of Canada. The government forecasts a 6.5% real GDP contraction in 2020 versus -6.1% for the entire country. The forecast for Quebec is broadly in line with our forecasts but somewhat more optimistic than the private sector average (-7.2%). The contraction is also the deepest since WWII. Absent of a severe coronavirus second wave, the government expects a 6.0% economic rebound in 2021. In a press conference, Minister Girard reiterated his intention to bring up Quebec trend GDP growth towards 2% once the effect of the pandemic dissipates. This remains a challenge considering the aging population and the long-term potential impact of Covid-19 on many domestic industries and international trade.

Revenues hit hard

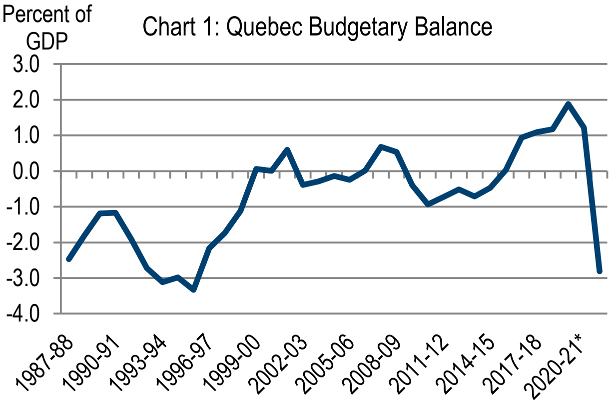
The impact of the economic downturn is felt through a $9.6B decline in own-source revenue relative to the March 2020 Budget. That is partly offset by an important $4.1B upward revision to transfers from the Government of Canada. Relative to FY 2019-20, a 6.3% decline in own-source revenue and a massive 27.2% decline in revenues from government business enterprises are forecast. The fiscal framework includes an additional $4.0B contingency fund (3.5% of revenues) to manage further potential revenue shortfall or additional expenditures if a Covid-19 second wave derails current projections.

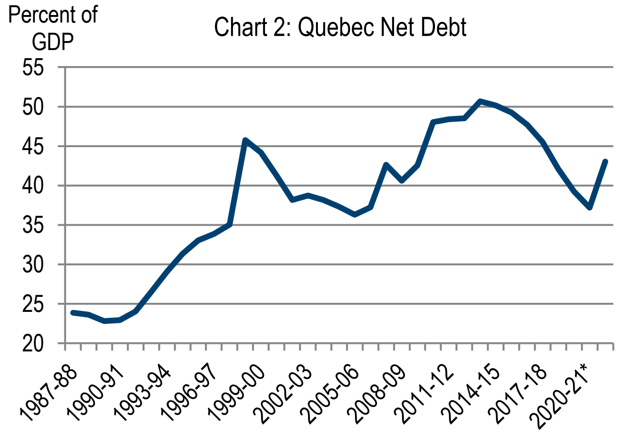
Support to health care professionals, workers and municipalities

Covid-19 related expenditures are estimated at $6.3B in FY 2020-21. The government dedicates as much as $3.5B in health care spending to improve health care workers' wages and to buy protective equipment. The cost of the various programs introduced to help essential workers and individuals (tax credit, direct monetary support and worker retention) totals $1.0B. Support to businesses and local governments worth $1.9B and includes $400M for public transit. Quebec provides further flexibility to municipalities by allowing them to postpone $337M in payments for Sûreté du Québec services. More announcements regarding municipal finance will come this fall. Overall, portfolio expenditures are forecast to grow 11.4% in FY 2020-21 to $115.5B, a similar pace to FY 2009-10 in response to the previous recession.

Record deficit offset by the Stabilization Reserve

Overall, the deficit is expected to reach $12.4B in FY 2020-21 (2.8% of GDP; Chart 1), *before* transfers to the Generations Fund. This most likely is the largest deficit in dollar terms on record and represents the highest as a share of GDP since FY 1994-95. Importantly, transfers of dedicated revenues to the Generations Fund are kept intact in FY 2020-21 and only slightly revised down to $2.6B from $2.7B in the March Budget. As a result, Quebec's deficit according to the *Balanced Budget Act* reaches $14.9B. To comply with the *Act* and therefore project a balanced budget, Quebec uses the entirety of its $14.9B stabilization reserve, reflecting surpluses accumulated over the past five years.





Note: *Before* transfers to the Generations Fund.
Source: Quebec Government, GoC Fiscal Reference Tables, LBS Econ. Res. and Strategy.

The Update's Press Release also mentions the government's intention to possibly review the *Act to reduce the debt and establish the Generations Fund*. Quebec reached the objectives set into the *Act* of reducing the gross debt-to-GDP below 45% by FY 2025-26 in FY 2019-20 and was on track to reduce its accumulated deficit-to-GDP to 17% in FY 2022-23. The COVID-19 shock will lift these debt ratios in FY 2020-21, therefore reducing the likelihood of reaching these goals by FY 2025-26. It is too early to tell if a modification of the *Act* will be required, depending notably on COVID-19 developments. It is also unclear if a modification of the *Act* would alter future transfers to Fund or postpone the long term debt objectives beyond 2025-26.

Higher borrowing program but debt ratios under control

This being said, the financial situation of the Province remains solid in FY 2020-21 despite the Covid-19 shock. All debt concepts (Gross Debt: 50.4% up from 43.4%, Net debt: 43% up from 37.2%, Accumulated deficit: 24.4% up from 20.7%, chart 2) remain significantly lower than their level prior to the start of Quebec's fiscal consolidation period in 2014 or before the 2008-09 Financial Crisis. Higher debt level translates into a revised up borrowing program from $13.9B estimated in March to $32.1B in June. As of this Friday, 40.3% of the program had already been completed. At 36.6%, the proportion of borrowing conducted in foreign markets, mainly U.S. dollars and Euros, is higher than its 21% historical average, reflecting Quebec strong access to international markets.

Looking toward balancing the Budget

Looking beyond 2020-21, the government intends to balance its budget within five years, in accordance with Quebec's Balanced Budget Legislation. Minister Girard also committed to do so without entering into a prolonged period of spending restraints. The Fall Update will provide more details about the plan but a crucial aspect is that the current deficit is mostly cyclical i.e. the contraction in revenue is expected to be reversed next year along with the rebound in economic growth and relief programs introduced this year are set to expire once the pandemic is over. However, some expenditure related to health care, notably higher wages, testing capacity and a much bigger inventory of personal protective equipment might persist for longer as the pandemic sets up new operating standards in this sector.

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